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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1979

MOBIL OIL CORPORATION,
Appellant,

vs.

COMMISSIONER OF TAXES OF VERMONT,
Appellee.

On Appeal From the Supreme Court of Vermont

BRIEF OF THE STATES OF ILLINOIS, CONNECTICUT, MASSACHUSETTS, AND NEW HAMPSHIRE AS AMICI CURIAE

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INTEREST OF THE AMICI CURIAE

Federal taxable income is the starting point for determining State income taxes in most States, including Illinois, Vermont, Connecticut, Massachusetts and New Hampshire. The concepts of fair apportionment and relief from tax inequities are also essential parts of your *Amici'* income tax provisions.

The appellant seeks to avoid Vermont's attempt to tax certain income solely because it is "foreign" income. If the appellant is successful, the consequences will be severe. Established constitutional principles regarding State taxation on an apportioned basis will be nullified. All components of income, particularly interest, capital gains, royalties, rents, dividends, and consultant fees, will be affected. This will have a marked impact on State revenues, and it will undermine the degree of fairness and uniformity the States have achieved in their taxation of residents and corporations.

This brief is submitted on behalf of the States of Connecticut, Illinois, Massachusetts, and New Hampshire. It is filed pursuant to Rule 42(4) of the Rules of this Court, and the consent of the parties is not required.

RELIANCE UPON FEDERAL TAXABLE INCOME IN THE APPORTIONMENT OF INCOME FOR STATE TAX PURPOSES DOES NOT VIOLATE EITHER THE DUE PROCESS CLAUSE OR THE COMMERCE CLAUSE.

INTRODUCTION

The *Amici,* like Vermont, rely upon federal taxable income, as defined in the Internal Revenue Code, 26 U.S.C. 1, et seq., as the starting point in their determination of the tax base of corporate taxpayers.[1] Conn. Gen. Stat. Ch. 208 § 12-213; Ill. Rev. Stat. ch. 120, § 203(d)(1); Me. Rev. Stat. Title 36 § 5102(8); Mass. Gen. Laws Ch. 63, § 30; N.H. Rev. Stat. 77-A:1(III and IV).

If a corporation conducts business activities both within and without a state, only a portion of its income is taxed by the State. In order to determine the portion of income which it may fairly subject to tax, each State applies an apportionment formula. Conn. Gen. Stat. Ch. 208, § 12-218(3); Ill. Rev. Stat. ch. 120, § 304; Me. Rev. Stat. Title 36 § 5210, 5211; Mass. Gen. Laws Ch. 63, § 38, N.H. Rev. Stat. Ch. 77-A:3.

The fact that these apportionment formulas may differ among the States does not violate either the Due Process Clause or the Commerce Clause. *Moorman Manufacturing* v. *Bair,* 437 U.S. 267, 98 S.Ct. 2340 (1978). Each apportionment formula consists of two basic parts—the apportionment factor

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[1] Each of the states which impose a direct tax on income excludes income which under the laws of the United States is exempt from taxation by the States. Principally this includes interest income on U.S. Government obligations. Some States provide for additional modifications such as the addition of municipal interest and the subtraction of State tax refunds. See Illinois Revised Statutes, ch. 120, § 203(b)(2).)

and the tax base.[2] The validity of Vermont's apportionment factor is not contested by appellant. Some States, like Vermont, include all taxable income in their tax base. 32 V.S.A. § 5811(18); N.H. Rev. Stat. 77-A:1 (III and IV). Other States have specific rules of allocation. Conn. Gen. Stat. Ch. 208, § 12-218; Ill. Rev. Stat. Ch. 120, § 303; Mass. Gen. Laws Ch. 63, § 38. Some States distinguish between business income and nonbusiness income, including only the former in their tax base.[3] Ill. Rev. Stat. ch. 120, § 303, 304, 1501(a)(1); Me. Rev. Stat. Title 36, § 5210(a).

Each State statute, like Vermont's, contains a relief provision whereby, if the apportionment formula does not apportion income in a manner which fairly represents the extent of its business activities within the state, the corporation may petition for such modifications as are necessary to achieve an equitable allocation and apportionment of income. Conn. Gen. Stat. Ch. 208, § 12-221(a); Ill. Rev. Stat. ch. 120, § 304(e); Me. Rev. Stat. Title 36, § 5211(17); Mass. Gen. Laws. Ch. 63, § 42; N.H. Rev. Stat. 77-A:3, III.

Appellant argues that only its commercial domicile may tax the dividends it receives from corporations which operate in foreign countries. *Amici* are concerned that many corporations with significant tax liability can and will assert this same proposition. *Amici* are also concerned that all income from

[2] The discussion in *Moorman* of the interrelation between Iowa's single apportionment factor and "other division of income problems", 437 U.S. at ____, 98 S.Ct. at 2347 is a recognition that the tax base is an integral factor in the apportionment formula.

[3] Illinois and Maine have adopted the Uniform Division of Income for Tax Purposes Act (UDIPTA) definition of business income. 'Business income' means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from the acquisition, management or disposition of tangible and intangible property when such acquisition, management or disposition constitute integral or necessary parts of the taxpayer's trade or business operations.

intangibles (such as interest, rents, royalties, license fees and capital gains) will be affected by ressurection of a commercial domicile theory of taxation. In addition, all income from domestic and foreign operations, production, services and sales will be affected by adoption of a geographical source theory of taxation. Also at stake is the preservation of the element of fairness inherent in a system of State taxation which relies upon federal taxable income, apportions income among the states, and provides relief upon a sufficient presentation of facts.

Mobil did not present any facts to prove that the management and control of the assets which yielded the dividends occurred in its commercial domicile. It simply stated that these activities took place outside of Vermont. (Appendix, p. 83) Implicit in the question of whether a non-domiciliary State may apportion "foreign" income are these two considerations: Can a non-domiciliary State apportion "foreign" income when the underlying assets are managed and controlled in *another* non-domiciliary State?; Can a non-domiciliary State apportion "domestic" income when the underlying assets are managed and controlled in the domiciliary State? *Amici* respectfully submit that this Court has already held that similiar "division of income" questions are political in character and deserving of action by Congress:

> It is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income. It is to that body, and not this Court, that the Constitution has committed such policy decision. *Moorman, supra,* 98 S.Ct. at 2348.

A.

Due Process Clause Considerations

With respect to the Due Process Clause, Mobil argues essentially that Vermont cannot apportion foreign dividend income because it does not have a "definite link" or "minimum

connection" with the ownership, management and control of Mobil's stocks and the dividends they produced, and it does not have a "nexus" with the payor corporations who operated almost entirely outside of the United States. (Appellant's Br. p. 9) The argument is based on Mobil's statement submitted at the hearing, but it is not supported by any legal authority. (Appellant's Brief, p. 9-13.) It simply states that the Due Process Clause requires an inquiry into the geographical location of the management of investments and the operations of payor corporations.

Appellant ignores the two restrictions placed on a State's power to tax income generated by interstate business activity which were expressly set forth in *Moorman, supra.* It does not argue that there is no minimal connection between its business activities and Vermont. Nor does it argue that there is no rational relationship between the income apportioned by Vermont and the values connected with Vermont. Instead, it attempts to avoid the effect of *Moorman, supra,* by asserting that the Due Process Clause places a third restriction on the State's taxation of income—that a state must have "jurisdiction" over each component of income included in its tax base. This proposition is also without legal authority, except for the two inheritance tax cases, the two use tax cases, and the two Commerce Clause cases cited in note 6 of Appellant's Brief at p. 12, none of which are apposite to an apportioned income tax case.

To place a jurisdictional requirement over each and every type of income would render the two due process restrictions in *Moorman* meaningless. A "jurisdictional" requirement in addition to a "nexus" requirement would also directly contradict the established line of cases in which an apportioned income tax withstood scrutiny under a due process inquiry. See *Underwood Typewriter Co.* v. *Chamberlain,* 254 U.S. 113 (1920); *Bass, Ratcliff and Gretton, Ltd.* v. *State Tax Commissioner,* 266 U.S. 271 (1924); *Butler Bros.* v. *McColgan,* 315 U.S. 501 (1942); *John Deere Plow Co. of Moline* v. *Franchise Tax Board,* 238 P.

2d 569, appeal dismissed, 343 U.S. 939 (1951) and *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450 (1959). The Due Process Clause requires a nexus between a State and the business activities of the taxpayer. It does not require a nexus between a State and each particular type of activity in which the taxpayer is engaged. ". . . (A)ppellant's claim that the Constitution invalidates an apportionment formula whenever it may result in taxation of some income that did not have its source in the taxing state is incorrect." *Moorman,* ____ U.S. at ____, 98 S.Ct. at 2344.

Curiously enough, appellant argues that "The activities, personnel and property of Mobil in Vermont, in which only the marketing of petroleum and related products was conducted, have nothing to do with Mobil's holding of stock in foreign subsidiaries or affiliates or its foreign investments, or the dividend income they produce." (Appellant's Brief p. 10.) This is precisely the factual predicate which, if established by clear and cogent evidence, would entitle Mobil to exclude its dividend income from Vermont's tax base.[4] Mobil did not attempt to prove this. Instead, it artfully phrased its proposed stipulation so as to avoid the obvious fact—Mobil's marketing activities in Vermont are related to its foreign investment activities.

Mobil operates a unitary business, and all of the income in issue was earned as a result of its unitary business activities. A review of the Annual Reports indicates that Mobil is engaged in the exploration, production, transportation, refining and marketing of petroleum related products throughout the world. See

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[4] Of course Mobil would also have to exclude the expenses incurred in earning these dividends, and it would have to omit the property, payroll and sales figures attributable to its "holding company" from the denominators of the apportionment factors. Assuming, *arguendo,* that dividends should be excluded from taxable income, the method of separate accounting used in Mobil's tax returns understates income by the deduction of "holding company" expenses, and by the failure to make the necessary eliminations from the property, payroll and sales denominators.

Exhibits 9, 11 and 13. The President of the company, Mr. William P. Tavoulareas, described the importance of the interdependence of Mobil, its subsidiaries and affiliates in testimony before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, United States Senate, on January 21, 1976. The record establishes that approximately 87% of the dividends at issue were paid by Mobil Marine Transportation Ltd., Mobil Oil Iraq with Limited Liability, Pegasus Overseas Ltd., and Arabian American Oil Company. Certainly if any of these companies had been engaged in a business unrelated to the production, transport and sale of petroleum products, it would have been in Mobil's interest to establish that fact.[5] [See Vermont's relief provision, 32 V.S.A. § 5833(b).]

An established line of cases concludes that the income of a unitary business is indivisible and that it should be taxed as such. *Adams Express Co.* v. *Ohio*, 165 U.S. 194 (1896), rehearing 166 U.S. 185 (1897); *Bass, Ratcliff and Gretton, Ltd., supra; Ford Motor Co.* v. *Beauchamp*, 308 U.S. 331 (1939); *Butler Bros., supra.*

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[5] Among other things, an inquiry into the relation between appellant and its investment in subsidiary and affiliated companies would reveal business activities similar to those revealed in *Appeal of Texaco, Inc.*, California State Board of Equalization, January 11, 1978, CCH-Cal.—p. 14, 905-54, para. 205-822. In that case, Texaco purchased a 7% interest in a consortium which acquired the exclusive right to use and manage all oil reserves, producing equipment, refining facilities, pipelines, etc. in Iran. Texaco formed a wholly owned subsidiary, Texaco Iran Ltd., and assigned to it all of its rights under the consortium agreement. The subsidiary had no employees and was, in effect, a "paper corporation". The subsidiary purchased oil from Iran at one-eighth (12½%) of the "posted price" as established by Iran. This oil was immediately sold at the "posted price" to another wholly owned subsidiary of Texaco, Texaco Overseas Petroleum Company (TOPCO). TOPCO resold the oil at the world price which was considerably lower than the "posted price". The net profits of Texaco Iran Ltd. were substantially greater than the losses sustained by TOPCO. Texaco paid the expenses of Texaco Iran Ltd. and, in return, received dividends from the subsidiary. Mobil's 10-K report to the SEC for year ending 12-31-73 at p. 32 indicates that Mobil owned a similar 7% interest in this consortium.

In *Bass, Ratcliff & Gretton, Limited* v. *Tax Commission, supra,* the British taxpayer argued that it: 1) "had no net income upon which it was subject to a federal income tax"; 2) New York was therefore imposing a tax on "a portion of its net income derived from business carried on outside of the United States"; 3) This tax was "a direct burden upon its foreign commerce in violation of the Commerce Clause of the Constitution". (id., 279-280) Despite these contentions, New York's tax on Bass' *world-wide income* (measured by a ratio of New York/World-wide real estate, tangible personal property, bills and accounts and stock ownership) was approved.

In *Butler Brothers, supra,* the taxpayer argued that its sales operations in California could be discontinued without any effect on its high volume buying power. However, Mr. Justice Douglas reasoned that the same argument could be made as to each of its several retail operations. It was the cumulative effect of the entire Butler Brothers' operations which made possible the profitable combination of high volume purchases and high volume sales.

The same principle is true for Mobil Oil Company. Its world-wide operations would not be materially affected if its marketing operations in Vermont were discontinued. Similarly, if every Mobil gas station in Illinois were shut down, its world-wide operations would still be enormous. However, it is the cumulative marketing power generated by its many state operations which make Mobil the petroleum giant it is. It is the unitary nature of its business which not only makes possible, but requires, Mobil's multi-billion dollar investment in domestic and foreign subsidiaries and affiliates. When a unitary business operates within and without a State, that State has the right to levy a reasonably apportioned tax on the unitary business income.

B.

Commerce Clause Considerations

Appellant argues that because of the risk of multiple taxation by the States, its foreign dividend income should only be included in the tax base of its commercial domicile. This argument is without merit.

Mobil does not contend that it experiences multiple taxation in fact. Mobil's commercial domicile does not tax 100% of dividend income; instead it relies upon a unique apportionment formula. N.Y. Tax Law §210(b). The basis of the decision by the court below was that Mobil had failed to establish that the State of commercial domicile had the power to tax 100% of dividends. Mobil does not cite any additional authority to this Court in support of the alleged power of the commercial domicile.[6]

In fact, appellant concedes that the "business situs" of the stock or the legal domicile may be more empowered to tax dividends than the commercial domicile. Appellant's Brief, p. 32, note 17. If stock or other intangibles "become an integral part of a business carried on in a State, they acquire a 'business situs' and may be taxed in that State [citations omitted.]" Appellant's Brief, p. 30, note 17. Of course, this is inconsistent with the legal authority cited above that all of the income generated by a unitary business may be apportioned, but it demonstrates that appellant recognizes the fallibility of its commercial domicile theory of taxation.

Neither the actuality nor the substantial risk of multiple taxation has been established. Even if it had been demonstrated, the domiciliary's law of allocation must yield to the

[6] Appellant continues to rely solely upon *Chestnut Securities Co.* v. *Oklahoma Tax Commission*, 125 F. 2d 571 (10th Cir., 1942), cert. denied, 316 U.S. 668 (1942); *Southern Pacific Company* v. *McColgan*, 68 Cal. App. 2d 48, 156 P. 2d 81 (1945); *United Gas Corporation* v. *Fontenot*, 241 La. 488, 129 So. 2d 748 (1961); and *Pacific Telephone and Telegraph Co.* v. *Franchise Tax Board*, 102 Cal. Reptr. 782, 498 P. 2d 1030 (1972). See note 17, Appellants Brief at p. 30.

nondomiciliary's law of apportionment. *Johns-Manville Products Corp.* v. *Comm. of Rev. Adm.*, 115 N.H. 428 (1975) appeal dismissed, 423 U.S. 1069 (1976). "Plaintiff argues further that since Mississippi has taxed the entire gain [from the sale of land located in Mississippi], the decision of the board will result in multiple taxation. Even if this were a valid objection, [citations omitted], plaintiff's complaint should not be directed against New Hampshire whose tax is fairly apportioned and constitutionally proper." 115 N.H. at 430.

The essence of this appeal is that since the geographical source of a component of income can be traced to a location outside of a taxing State, that State must exclude the component of income from its apportionment formula. This is a common problem among the States. Typically multistate, multinational corporations attempt to exclude interest, dividends, capital gains, rents, royalties and management fees. Any decision which allows the exclusion of one component of income implicitly jeopardizes all other components of the States' tax base.[7] This, in turn, affects tax rates, it affects the fairness of a tax system to all taxpayers and it affects the states vying with each other to attract business.

When asked, the State Supreme Courts have consistently focused on the unitary nature of the business organization and the activities which are integral to its overall profitability. These Courts have unanimously decided in favor of apportioning income which is generated by the business activities of the taxpayer rather than attributing income to a geographical source. *Qualls* v. *Montgomery Ward & Co.*, ____ Ark. ____ (decided July 2, 1979) (interest on loans to subsidiary, affiliate, parent and related corporations); *W.R. Grace & Co.* v. *Comm. of Rev.*, ____ Mass. ____ (decided June ____, 1979) (gain on

[7] The taxability of "domestic" dividends and interest was contested by Mobil in its appeal to the Court below. Were this Court to adopt Mobil's argument with respect to either the Due Process Clause or the taxing power of the commercial domicile, it would follow that "domestic" dividends and interest could be excluded from apportionable income.

sale of Miller Brewing Co.); *Albany International Corp.* v. *Halperin*, 388 A.2d 902 (Me. 1978) (capital gains, royalties and interest); *Montana Dept. of Rev.* v. *American Smelting and Refining Co.*, 567 P. 2d 901 (Mont., 1977), appeal dismissed, 434 U.S. 1042 (1978) dividends, interest and capital gains); *ASARCO, Inc.* (formerly *The American Smelting and Refining Co.*) v. *Idaho State Tax Comm.*, ____ P. 2d ____ (decided March 12, 1979), U.S. Docket (No. 78-1839) (interest, rents, royalties, capital gains and some dividends were "business income," some dividends were "nonbusiness income.")

C.

Fairly Apportioned State Taxation Cannot Be Circumvented by Business Transactions Abroad

In the present appeal, Mobil is seeking to avoid fair apportionment. If this Court were to concur, Mobil could allocate 100% of its $637,666,486.18 income from its investments abroad to New York,[8] a State which chooses not to tax such income.[9] Thus, Mobil could effectively secure a substantial competitive advantage for itself.

There is, however, the underlying constitutional issue of whether *any* State can tax income from investments and operations abroad. One of the *Amici*, the Committee[10] On State Taxation, declares that:

[8] 1970-1972 dividend income, *only* per Appendix pp. A 37,51,65.

[9] New York is Mobil's commercial domicile. In urging 100% allocation of income from investments abroad to States of commercial domicile, Mobil side-steps the rights of the States of legal domicile. For example, one of Mobil's subsidiaries, ARAMCO, has its legal domicile in Delaware and its commercial domicile in New York.

[10] The Committee's constitutional argument is not new. In 29 Vanderbilt Law Review, 401, 404 (March, 1976), it is observed that:

> The Committee on State Taxes of the Council of State Chambers of Commerce (cost), which is composed of ninety-two of the

(footnote continued on following page)

> . . . the multiple taxation of which Mobil complains occurs not from overlapping State apportionment formulas (J.S. App C, p. 26a) but from the compounding of tax after tax on the same foreign source income.
>
> * * *
>
> . . . the Vermont tax system discriminates against investment in foreign corporations by domestic operations and to that extent imposes a burden on foreign commerce that does not apply to domestic commerce.
> (Committee's Amicus brief at pp 17, 4a)

Manifestly, by asserting this prerequisite constitutional issue, the Committee is seeking to have its members' income from international investments and ventures declared *wholly exempt*. The Committee's objective cannot be achieved if this Court merely substitutes a commercial domicile test for fair apportionment. Illinois, for example, is the commercial domicile of numerous multinational corporations, just one of which announced that:

> In 1974 the Company's business activities made a net contribution of $1.2 billion towards a favorable U.S. balance of payments (including) . . . other sources of foreign income such as dividends, license fees and interest. (1974 Annual Report, Caterpillar Tractor Co., p. 9)

Thus, if Mobil were to prevail, the result would actually be inimical to the interests of numerous corporations. The Committee recognizes that many of its members could suddenly find themselves subject not to fair apportionment, but to a tax on 100% of their investment income by their commercial domicile. Such a marked change to the established framework of State

(footnote continued from preceding page)

> nation's one hundred largest corporate businesses, apparently takes the basic position that intercorporate dividend income should be exempt from state taxation since it has no 'source' apart from the underlying income-producing activities of the payor corporation.

taxation could sorely test the desire of the Framers of the Constitution "to prevent interstate rivalry and friction". *Department of Revenue vs. Association of Washington Stevedoring Companies*, 98 S.Ct. 1388, 1401 (1978). Obviously the effect on both States and corporations would be revolutionary.

Fortunately, the *Japan Line, Ltd.*,[11] decision relied upon so heavily by both Mobil and the Committee actually *belies* their contentions. It specifically held that:

> The basis for this Court's approval of apportioned property taxation, in other words, has been its ability to enforce full apportionment by all potential taxing bodies.
>
> * * *
>
> ... the medieval maxum *mobilia sequntur personum* ('movables follow the person') ... resulted in personal property being taxable in full at the domicile of the owner. This theory of taxation has fallen into desuetude... (id., 99 S.Ct. at 1818, 1821)

In *Mobil*, this Court confronts no barrier to "its ability to enforce full apportionment by all potential taxing bodies" as it did in *Japan Line, Ltd.* All of Mobil's income from its investments and operations abroad is U.S. income. The Internal Revenue Code (26 U.S.C. § 1, *et seq.*) requires all such income to be reported as part of every corporation's Federal Taxable Income.[12] Whether Mobil chooses to invest its Vermont or Illinois profits in an Alaskan oil subsidiary or a Middle East subsidiary, the same result must follow. Mobil's return on its investments is still derived from and is an integral part of its U.S. income. Mobil would have had neither the investment

[11] *Japan Line Ltd.* v. *County of Los Angeles*, 99 S.Ct. 1813 (April 30, 1979)

[12] To exclude all "foreign" income from Federal Taxable Income would create complex accounting problems equaled only by the difficulty of conducting an accurate tax audit. Every separate item of "foreign" income and expense for each "foreign" transaction would have to be examined to determine if such item was truly "foreign" or "domestic". (See 42 Journal of Taxation, State and Local Taxation, p. 106, Feb., 1975)

capital nor the need to invest in Alaskan or Middle East oil ventures but for the markets, profits and services provided by each of the States in which Mobil conducts its on-going business activities. Thus, the circumstances in Mobil are very different from those in *Japan Line, Ltd.* Mobil's net profits from investments and operations abroad are not "instrumentalities of foreign commerce" used solely as "continuations of international voyages". (id., 99 S.Ct. at pp. 1820, 1815) Unlike the direct property tax in *Japan Line, Ltd.*, there is no danger in *Mobil* that:

> foreign nations disadvantaged by the levy [of a fairly apportioned State tax on Mobil's investment income] may retaliate against American-owned instrumentalities present in their jurisdictions. (id., 99 S.Ct. at 1822)

Clearly, there can be no disadvantage to foreign nations caused by fairly-apportioned State taxes based upon a corporation's Federal Taxable Income. Thus, the Committee's charge that any State taxes, fairly apportioned or not,

> ... would place de facto control over foreign commercial policy in the several States and make decisions at the Federal level on this vital matter subservient to the day-to-day State revenue concerns

is simply untrue. In fact, the Committee's stance could result in severe discrimination against *domestic* investment. If all State taxation could be wholly avoided by U.S. investments and ventures abroad, domestic investments would be comparatively less profitable. Where net profit is the bottom line, such simple avoidance of State taxes would become a pragmatic requirement.

CONCLUSION

Appellant did not present sufficient facts to the Commissioner to establish its entitlement to relief under 32 V.S.A. § 5833(b), and it has not demonstrated in this appeal that the income apportioned by Vermont is unfair or unreasonable in a constitutional sense. *Amici* respectfully urge the affirmance of the judgment of the court below.

Respectfully submitted,

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